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No. 202

# In the Supreme Court of the United States

OCTOBER TERM, 1930

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SALLIE H. HENRY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF

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No. ——

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, petitioner

*v.*

SALLIE H. HENRY

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF

### PETITION

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above entitled cause on March 17, 1930 (R. 98), reversing the decision of the United States Board of Tax Appeals. (R. 26–29.)

### STATEMENT

This case reached the Circuit Court of Appeals for the Third Circuit on the petition of Sallie H. Henry, respondent herein, for a review of the deci-

sion of the Board of Tax Appeals determining a deficiency in respondent's income tax for the calendar year 1921.

The facts as found by the Board of Tax Appeals are as follows (R. 19–25):

The respondent was a stockholder of the Real Estate Trust Company of Philadelphia, a banking institution. The Trust Company closed its doors in the year 1906, and on August 28th of that year George H. Earle, Jr., was appointed receiver. The financial embarrassment of the Trust Company was brought about by the improper conduct of its affairs by its president, Frank Hipple. Hipple loaned excessive amounts to one Adolph Segal, and took therefor collateral which could not be easily liquidated, but which was not without value.

The receiver for the Trust Company evolved a plan for reorganization which included as one of its provisions the creation of a fund of $2,500,000 from subscriptions by directors of the company. The company was to be given the $2,500,000 outright, and the subscribers were to be reimbursed, if at all, by all of the excess over $3,000,000 which might be realized from the "Segal Matters." This plan of reorganization became effective and the subscribers to the $2,500,000 fund made their subscriptions with the understanding that if, from the administration of the "Segal Matters," $3,000,000 should be realized, the subscribers were to receive any excess over this amount which might be realized

from the same. No restrictions or time limits were placed upon the Trust Company in regard to its administration and final disposition of the assets available to the Trust Company in the "Segal Matters."

The Trust Company resumed business on November 1, 1906, and thereafter and until December 30, 1920, the "Segal Matters" were administered exclusively by it under the direction of George H. Earle, Jr., formerly receiver and thereafter president of the company.

The respondent contributed $200,000 to the fund, through her brother, Samuel F. Houston, who acted throughout the transaction as her agent. She made her subscription upon the understanding that no personal responsibility to her was assumed by Samuel F. Houston, but that she was to look to the so-called "Segal Matters" as the source from which to realize upon her subscription. Samuel F. Houston explained the plan of reorganization to the respondent, and told her of his beliefs in regard to the value and possibilities of the "Segal Matters."

At the time the subscriptions to the guaranty fund were made, a suit against the American Sugar Refining Company under the Sherman Anti-Trust Act was contemplated on behalf of the Pennsylvania Sugar Refining Company, and the value of the "Segal Matters" depended to some extent upon the successful prosecution of such a suit. Suits were brought for $10,000,000, and in January, 1910,

the litigation was compromised upon the delivery to the Trust Company, by the American Sugar Refining Company, of certain bonds wrongfully withdrawn from the Trust Company, among which were bonds of the Pennsylvania Sugar Refining Company. The Trust Company afterwards converted the latter bonds, through a foreclosure, into 7,268 shares of stock in a reorganized company, thereafter called the Pennsylvania Sugar Company. This was on or before January 22, 1912.

Some question arose between the parties in regard to their rights under the subscription agreement, including the right to interest, and on May 5, 1916, a supplemental agreement was entered into. At this time, and for some time prior thereto, the principal unliquidated asset of the original "Segal Matters" was the 7,268 shares of stock in the Pennsylvania Sugar Company, and under the supplemental agreement it was provided that when this stock was disposed of the contributors to the guaranty fund should receive one-fourth of the proceeds.

In the latter part of 1920, the parties concerned, after full investigation, concluded that the liquidation agreement had rendered its maximum of service, and that the remaining Segal assets would not have any greater value during a substantial period of time in the future than they then had. Whereupon, the subscribers, either individually or by their duly constituted representatives, entered into

separate agreements which as a group provided for complete liquidation of the "Segal Matters" by the Trust Company. Distribution of one-fourth of the 7,268 shares of the Pennsylvania Sugar Company stock was made to the subscribers to the fund in proportion to the amount of their subscriptions in full satisfaction and discharge of their interest in the "Segal Matters." The subscribers never received any other return on their subscriptions.

Samuel F. Houston entered into such an agreement on December 30, 1920, and on that date, in accordance with the terms of the agreement, received 548.734 shares of the Pennsylvania Sugar Company stock. He personally was entitled to 222 of these shares. The remaining shares he received as agent for his sisters and others who had subscribed through him. These latter shares were distributed to them by him, 158.61 shares being delivered to respondent in the early part of 1921.

At the time of the distribution, each share of stock of the Pennsylvania Sugar Company had a fair market value of $150.

In reporting her income for 1921, respondent deducted as a loss the difference between the amount subscribed to the guaranty fund and the value of the shares received. The Commissioner of Internal Revenue disallowed the deduction and found a deficiency in tax of $100,870.29. The respondent appealed to the Board of Tax Appeals. The Board sustained the action of the Commissioner, holding that the loss, if any, would be the difference be-

tween what was received for the property right and its cost or March 1, 1913, value, whichever was lower, and that since no effort was made by the respondent to show the March 1, 1913, value of the right in question, no deductible loss was established. The Board further held that since her share of the Pennsylvania Sugar Company stock was received in 1920, by her brother, Samuel F. Houston, as her agent, the transaction was closed in that year rather than in 1921, and that the loss, if any, was therefore sustained in 1920. The respondent filed a petition for a review by the Circuit Court of Appeals for the Third Circuit of the decision of the Board (R. 29), and on March 17, 1930, the Circuit Court of Appeals, relying on its previous decision in *Houston* v. *Lucas*, a petition for certiorari in which was filed by the Government on June 14, 1930 (No. 199), reversed the Board's decision, holding that the respondent's loss was the difference between the cost of the right in 1906 and the amount realized. It further held that the loss was deductible in 1921, for the reason that the evidence was too unsubstantial to prove agency.

SPECIFICATION OF ERRORS TO BE URGED

The court below erred—

1. In failing to hold that only those losses are deductible from gross income which are sustained after March 1, 1913;

2. In failing to hold that the ascertainment of the March 1, 1913, value was necessary for the pur-

pose of apportioning the total loss between the periods before and after March 1, 1913;

3. In holding that the deductible loss was the difference between the cost of the right in 1906 and the amount subsequently realized, there being no evidence that any portion of said loss had been sustained subsequent to March 1, 1913;

4. In failing to hold that the burden was upon the respondent to prove the March 1, 1913, value of her property right to support a claim for a deductible loss;

5. In holding that under the facts in this case the respondent was relieved of the necessity of establishing the March 1, 1913, value of her property right.

## REASONS FOR GRANTING THE WRIT

1. The decision in the present case is in conflict with the decisions of this Court.

In *United States* v. *Flannery*, 268 U. S. 98, this Court held that March 1, 1913, is a controlling date because the statutory provisions regarding value on that date are a limitation upon the amount of the actual gain or loss that would otherwise have been taxable or deductible. In this case the lower court imposed no such limitation. It allowed all losses subsequent to 1906 to be deducted even though there was evidence to indicate that a substantial part of the loss had been sustained prior to 1913. (R. 88.)

In *Lucas* v. *Alexander*, 279 U. S. 573, this Court held that the purpose of ascertaining the March

1, 1913, value of property is to apportion the total gain which has accrued between the periods before and after March 1, 1913. Under the *Flannery* decision the same rule is applicable to losses.

In *Reinecke* v. *Spalding*, 280 U. S. 227, this Court held that the burden was upon the taxpayer to establish his right to a deduction disallowed by the Commissioner of Internal Revenue. The respondent presented no evidence of the value of her right on March 1, 1913.

2. The decision in the present case is in conflict with the decisions of the Court of Appeals of the District of Columbia in *Ayer* v. *Blair*, 26 F. (2d) 547, and the Circuit Court of Appeals for the Eighth Circuit in *Holmquist* v. *Blair*, 35 F. (2d) 10.

In *Ayer* v. *Blair, supra*, a taxpayer advanced moneys to an insolvent corporation in 1908, and obtained a partial recoupment in 1920. The court held that the only loss deduction that the taxpayer could have in 1920 was the difference between the 1913 and the 1920 values of his claim to recoupment.

In *Holmquist* v. *Blair, supra*, the court held that the March 1, 1913, value of the taxpayer's property interests was a matter of evidentiary proof, and that, to show error on the part of the Commissioner of Internal Revenue, value on that date must be proved.

3. The question is of present importance in the administration of the tax laws. The Revenue Act

of 1924 and subsequent Acts provide a different basis for measuring gains or losses on the sale or other disposition of property acquired prior to March 1, 1913, but the necessity of establishing value as of that date has not been removed.

Wherefore, it is respectfully submitted that the petition should be granted.

THOMAS D. THACHER,
*Solicitor General.*

JUNE, 1920.

## BRIEF IN SUPPORT OF PETITION

### OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 96) is reported in 39 F. (2d) 358. The opinion of the Board of Tax Appeals (R. 26) is reported in 13 B. T. A. 279.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 17, 1930. (R. 98.) Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

### QUESTION PRESENTED

Was it incumbent upon the respondent to establish the March 1, 1913, value of her property right acquired prior to that date, to support a claim for a deductible loss on the disposition of such property in 1921?

We do not request consideration of the further question which was raised in the court below, whether there was sufficient evidence to support the Board's conclusion that Samuel F. Houston acted as respondent's agent in making the final settlement with the Trust Company, as this question is not of public importance.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1921, c. 136, 42 Stat. 227, 229, 230, 239, 240—

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * *

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit * * *.

SEC. 202 (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; * * *.

(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but

* * * * *

(2) If its fair market price or value as of March 1, 1913, is lower than such basis, the deductible loss is the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; * * *

(3) If the amount realized therefor is more than such basis but not more than its fair market price or value as of March 1, 1913, or less than such basis but not less than such fair market price or value, no gain shall be included in and no loss deducted from the gross income.

Treasury Department Regulations 62 (1922 edition) relating to the Revenue Act of 1921—

ART. 1561. *Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property, the basis is the cost of such property, or in the case of property which should be included in the inventory, its latest inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain to be included in gross income is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or exchanged (a) at more than cost but at less than its fair market value as of March 1, 1913, or (b) at less than cost but at more than its fair market value as of March 1, 1913. * * * What the fair market value of property was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. * * *

STATEMENT

The facts are stated in the petition for certiorari.

## ARGUMENT

The question presented is the same as that in *Robert H. Lucas, Commisisoner of Internal Revenue, Petitioner* v. *Samuel F. Houston,* No. 199, October Term, 1930, now pending in this Court on petition for writ of certiorari filed on June 14, 1930. The argument in the brief in support of that petition is here incorporated by reference.

## CONCLUSION

Because of the importance of the question involved in the administration of the tax laws, and the conflict of decisions thereon, it is submitted that the petition should be granted.

Respectfully submitted.

THOMAS D. THACHER,
*Solicitor General.*
G. A. YOUNGQUIST,
*Assistant Attorney General.*
J. LOUIS MONARCH,
JOHN G. REMEY,
*Special Assistants to the Attorney General.*
W. MARVIN SMITH,
*Attorney.*
C. M. CHAREST,
*General Counsel,*
*Bureau of Internal Revenue,*
ALLIN H. PIERCE,
*Special Attorney,*
*Bureau of Internal Revenue.*

JUNE, 1930.

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